[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS
(S. 1600, S. 1579, S. 108, S. 1464, and S. 1549)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON AUGUST 1, 1983

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

JULY 29, 1983

U.S. GOVERNMENT PRINTING OFFICE

23-283 O WASHINGTON : 1983 JCS-37-83

J 862-44
S 362-33

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INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on August 1, 1983, by the Senate Finance Subcommittee on Taxation and Debt Management.

The five bills scheduled for the hearing, in the order listed in the press release announcing the hearing, are S. 1600 (relating to indexing the basis of certain assets), S. 1579 (relating to charitable deduction for use of passenger automobile), S. 108 (relating to tax incentives for vocational education programs), S. 1464 (relating to exemption from divestiture requirements of excess business holdings provision for the El Pomar Foundation), and S. 1549 (relating to exemption from unrelated business income tax for income from certain oil and gas property).

The first part of the pamphlet is a summary of the bills. This is followed in the second part by a more detailed description of the bills, including present law, explanation of provisions, and effective dates.

I. SUMMARY

1. S. 1600—Senator Armstrong

Indexing the Basis of Certain Assets

Under present law, the adjusted basis for determining gain or loss from the disposition of capital assets is established in fixed dollar amounts. Thus, changes in the value of the dollar resulting from inflation are not taken into account for this purpose.

The bill would provide for an inflation adjustment (i.e., indexing) to the basis of certain assets for purposes of determining gain or loss on a taxable disposition. The adjustment would be applicable to certain corporate stock and real property interests. The adjustment would apply only to inflation occurring after 1983. The inflation adjustment would not apply for purposes of determining depreciation and other cost-related deductions.

2. S. 1579—Senator Armstrong

Charitable Expense Deduction for Use of Passenger Automobile

Under present law, individual taxpayers may deduct charitable contributions up to certain limits (Code sec. 170). In determining the amount of their charitable contribution deduction, taxpayers may deduct their actual fuel expenses for a vehicle used to provide services to a charitable organization, or may use a standard rate of nine cents a mile.

Under the bill, taxpayers would be allowed to use the standard mileage rate authorized for computing the business expense deduction for business use of a passenger automobile. At present, that rate generally is 20 cents a mile for the first 15,000 miles of business use, and 11 cents a mile for each additional mile. The bill would apply to taxable years beginning after 1982.

3. S. 108—Senators Grassley, Jepsen, Durenberger, and Thurmond

Tax Incentives for Vocational Education Programs

a. Increased charitable deduction for contributions of equipment to postsecondary vocational education programs

Present law

In general, the amount of charitable deduction otherwise allowed for donated property must be reduced by the amount of any ordinary gain which the taxpayer would have realized had the property been sold at its fair market value on the date of the donation (sec. 170(e)). For example, a manufacturer that makes a charitable donation of inventory generally may deduct only its basis in the property.

However, under a special rule, corporations are allowed an augmented charitable deduction for donations of newly manufactured scientific equipment to a college or university for research use in the physical or biological sciences (sec. 170(e)(4)). The augmented deduction is generally for the sum of (1) the corporation's basis in the donated property and (2) one-half of the property's unrealized appreciation. In no event may the amount of the deduction under the special rule exceed twice the basis of the property.

Explanation of provision

Section 1 of the bill would provide an augmented charitable deduction for corporate or other taxpayers making certain donations of tangible personal property to institutions of higher education which use the property to train students enrolled in a postsecondary vocational education program.

For qualifying donations, the augmented charitable deduction allowed generally would equal the sum of the taxpayer's basis in the donated property and one-half of the property's unrealized appreciation. In no event would a deduction be allowed for any amount which exceeded twice the property's basis.

This provision of the bill would be effective for donations made after 1982.

b. Postsecondary vocational education instruction tax credit

Present law

Employers generally may deduct as an ordinary and necessary business expense a reasonable allowance for compensation paid employees (sec. 162). Thus, a manufacturer, for example, generally may deduct reasonable compensation paid to vocational education teachers who work temporarily for the manufacturer to upgrade their skills, although regularly employed by teaching institutions.

Present law also provides a targeted jobs credit to employers who hire individuals belonging to any of several defined groups (sec. 51). The targeted jobs credit is available with respect to certain vocational education students employed under cooperative education programs; it does not apply to vocational education teachers.

Explanation of provision

Section 2 of the bill would provide a nonrefundable credit with respect to (1) postsecondary vocational education courses taught by qualified teaching employees of the taxpayer and (2) vocational education instructors temporarily employed by the taxpayer.

The amount of the new credit would be $100 for each postsecondary vocational education course taught by a qualified teaching employee during the taxable year (not to exceed five courses per employee per year), plus $100 for each qualified vocational education instructor temporarily employed during the taxable year.

The bill specifies that the credit would be in addition to allowable deductions for compensation paid to employees.

This provision of the bill would be effective for taxable years beginning after 1982.

4. S. 1464—Senators Armstrong and Hart

Exemption from Divestiture Requirements of Excess Business Holdings Provision for the El Pomar Foundation

The bill would exempt the El Pomar Foundation of Colorado Springs, Colorado, from the divestiture requirements with respect to excess business holdings which apply to private foundations (sec. 4943).

5. S. 1549—Senators Armstrong, Long, Durenberger, Wallop, Grassley, Symms, Bentsen, Baucus, Boren, and Pryor

Exemption from Unrelated Business Income Tax for Income from Certain Oil and Gas Property

Under present law, most organizations which generally are exempt from Federal income taxation under Code section 501(a), including any trust that is part of a tax-qualified pension, profit-sharing, or stock bonus plan described in section 401(a), are subject to tax on any unrelated business taxable income (secs. 511-514). In addition, a tax is imposed on the unrelated trade or business income of an individual retirement account or annuity (an IRA).

Under the bill, certain exempt organizations would be permitted to invest in limited partnerships owning working interests in domestic oil and gas properties without incurring tax for unrelated business income. The organizations that would be eligible under this provision include exempt trusts forming a part of tax-qualified pension, etc., plans, IRAs, and certain tax-exempt educational organizations. The bill would apply for partnership taxable years beginning after 1982.

II. DESCRIPTION OF BILLS

1. S. 1600—Senator Armstrong

Indexing the Basis of Certain Assets

Present Law

A taxpayer generally recognizes gain from an increase in value of a capital asset, or takes into account an allowable loss from a decline in value of the asset, only on the sale, exchange, or other disposition of the asset. If the taxpayer continues to hold the asset, no appreciation in value of the asset is includible in income, and no loss is allowable for any decline in value.

Gain on disposition of a capital asset which has been held for more than one year is taxable at reduced rates. Capital assets generally include property held by the taxpayer other than property held for sale to customers and property used in the taxpayer's trade or business. In addition, gain from the disposition of property used in a trade or business, in excess of depreciation recapture, may be treated as gain from the sale of a capital asset.

For a noncorporate taxpayer, only 40 percent of net capital gains (i.e., the excess of net long-term capital gain over net short-term capital loss) is included in taxable income. These gains are therefore taxable at a maximum 20-percent rate. For corporations, an alternative tax rate of 28 percent applies to net capital gain if the tax computed using that rate is lower than the corporation's regular tax.

The reduced tax rates for capital gains are taken into account as preference items for purposes of the corporate and noncorporate minimum taxes.

Background

Effect of inflation—U.S. tax law

The Federal tax law generally does not take inflation into account in determining taxable income. For example, under U.S. tax law, the adjusted basis for determining gain or loss from a taxable disposition of property is established in fixed dollar amounts. Thus, the law does not take into account for this purpose changes in the value of the dollar resulting from inflation.

For example, a taxpayer who purchases a share of stock for $100, and sells the stock for $150 ten years later, recognizes $50 of income in the year of sale. This is the result notwithstanding that, to the extent inflation has occurred during these years, it would require more than $100 at the time of disposition to return to the taxpayer the $100 in value invested in the asset. The $50 of income

recognized generally would be subject to the reduced tax rates applicable to capital gains.

For certain other purposes, U.S. tax law does take inflation into account. Under the Economic Recovery Tax Act of 1981, income tax brackets for individuals, as well as the zero bracket and personal exemption amounts, will be adjusted each year for inflation beginning in 1985 (Code sec. 1(f)). The adjustment for each year will be based upon the percentage by which the consumer price index (CPI) for the preceding year exceeds the CPI for 1983. This provision is designed to prevent taxpayers from being pushed into higher percentage tax brackets by inflation.

In addition, the base price for determining the windfall profit tax on domestic crude oil is adjusted for inflation as measured by the implicit price deflator for the gross national product (sec. 4989(b)). Further, beginning in 1986, the limits on contributions to, and benefits from, a qualified pension plan will be adjusted for post-1984 cost-of-living increases, as determined under the formula then in effect for determining social security benefit levels (sec. 415(d)(2)).[1]

Effect of inflation—foreign tax laws

United Kingdom

In 1982, the United Kingdom enacted an indexation allowance for assets held for one year or longer.[2] The allowance applies only for inflation occurring after 1982. The allowance is based on the percentage by which the retail price index for the month in which an asset is disposed of exceeds the index at a time one year after the related expenditure was made. The amount of any capital gain is reduced by the indexation allowance for the applicable holding period. Where the allowance exceeds the adjusted gain, no gain or loss is recognized. The allowance is not applicable to capital losses.

Canada

The Canadian Government, in its budget of April 1983, proposed an elective indexation program for Canadian securities, known as the Indexed Security Investment Plan (ISIP).[3] The plan would be limited to publicly listed common stock of Canadian corporations.

Under the Canadian plan, stock purchased under an ISIP would be adjusted each month according to the percentage increase in the consumer price index. At the end of each year, the investor would be required to recognize 25 percent of the real increase in value of the investment (i.e., after adjusting for the inflation rate) over the course of the year. The remaining 75 percent of increased value would be deferred until the succeeding year, to be taxed (together with any real increase in value during the succeeding year) under the same formula (i.e., 25 percent of the 75 percent would be taxed in the succeeding year). Any remaining untaxed increase in value

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[1] The Tax Equity and Fiscal Responsibility Act of 1982 suspended the otherwise allowable cost-of-living adjustment for the years 1983, 1984, and 1985.

[2] Finance Act 1982, secs. 86, 87.

[3] Budget Speech, delivered in the House of Commons by the Honourable Marc Lalonde, Minister of Finance, April 19, 1983. Canada has indexed personal income tax brackets and exemptions since 1974.

would be taxed on disposition of the investment. The plan generally would treat losses in the same manner as capital gains.[4]

Investors would be allowed to transfer presently held securities to an ISIP. However, these securities would be indexed only for the period beginning in 1983.

The Canadian Government plans to deny an interest deduction on funds borrowed for ISIP investments.

Explanation of the Bill

Overview

The bill would provide generally for an inflation adjustment to (i.e., indexing of) the basis of certain assets for purposes of determining gain or loss on disposition. Assets eligible for the inflation adjustment would be certain corporate stock and real property. The adjustment would be applicable only to assets held for more than one year.

The adjustment would be based on the level of the gross national product (GNP) deflator for the calendar quarter in which disposition takes place compared with the deflator for the quarter in which the asset was acquired. The inflation adjustment would apply only to inflation occurring after 1983.

Under the bill, the inflation adjustment would apply with respect to sales, exchanges, or other dispositions of property. However, the adjustment would not apply for purposes of determining any deduction for depreciation, cost depletion, or amortization.

Indexed assets

Stock.—The bill would generally provide for the indexing of corporate stock which is a capital asset. (For this purpose, options, warrants, or other contract rights with respect to stock would not be considered stock.) However, no adjustment would be allowed in the case of preferred stock which provides for a fixed return with no significant participation in corporate growth. The inflation adjustment also would not apply to stock in an S corporation, in a personal holding company, or, in general, in a foreign corporation.[5] An interest in a common trust fund would be treated as stock.

Realty.—The bill would provide for indexing of real property (or any interest therein) which is a capital asset or property used in a trade or business (within the meaning of sec. 1231). This includes land, leasehold interests, and buildings. However, the inflation adjustment would not apply (1) to any contract rights with respect to real property which are not themselves real property, (2) to any mortgage or other creditor's interest, or (3) to realty subject to certain long-term net leases.

General requirements.—The bill would apply only to assets held for more than one year. An asset would not be treated as an in-

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[4] Canadian law generally requires that only one-half of recognized capital gain be included in income. Thus, under an ISIP, one-half of 25 percent of increased value would actually be subject to tax in each year.

[5] However, the inflation adjustment would apply to stock in foreign corporations which is traded on an established domestic securities market, other than stock in foreign investment companies or stock held by persons subject to potential dividend treatment on the sale of the stock.

dexed asset for any period during which the taxpayer, or his or her spouse, has sold short property substantially identical to the asset.

Computation of inflation adjustment

The inflation adjustment under the bill would be computed by multiplying the taxpayer's adjusted basis in the indexed asset by the ratio of the GNP deflator for the calendar quarter in which disposition of the asset takes place to the deflator for the quarter in which the asset was acquired.[6] For example, if the deflator at the time of sale was 50 percent higher than at the time of acquisition, the gain or loss would be determined by reducing the sales proceeds by an amount equal to 150 percent of the asset basis at the time of acquisition.

If the inflation adjustment exceeds the amount of gain (determined without the adjustment) on disposition of an indexed asset, the taxpayer would recognize a loss to the extent of the excess. However, any loss created (or increased) by application of the inflation adjustment would be treated as a capital loss, regardless of other provisions of the Code.

In the case of an asset acquired before 1984, the GNP deflator for the quarter ending December 31, 1983, would be used to compute the inflation adjustment. Thus, the bill would not provide an adjustment for inflation occurring before 1984.[7]

Pass-through entities

Under the bill, partnership interests and stock of S corporations would not be treated as indexed assets. However, any adjustment made with respect to assets held at the entity level would be passed through to the partners or S corporation shareholders for purposes of determining gain or loss on disposition of their partnership interests or stock.

Special rules would apply in the case of regulated investment companies (mutual funds), real estate investment trusts, and common trust funds which hold indexed assets. In general, stock in these entities would qualify for partial indexing based on the ratio of the value of the indexed assets held by the entity to its total assets.

Special rules

The bill would disallow the inflation adjustment in cases of transfers between related persons except to the extent the transferee has a carryover basis in the asset. Also, the bill would authorize the Treasury Department to disallow all or part of an adjustment if the principal purpose of a transfer of an asset is to create or increase an inflation adjustment (or to increase a deduction by reason of such adjustment).

The bill also would provide that, if the inflation adjustment has already been applied to an asset while it was held by the taxpayer,

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[6] The GNP deflator is an index of the price of all goods and services produced in the United States in the relevant quarter. By contrast, the consumer price index measures the price of consumer goods (including imports) during the relevant period.

[7] Although the language of the bill as introduced refers to inflation occurring after December 31, 1984, it is understood that the bill is intended to take into account, as well, inflation occurring during 1984.

the taxpayer may not claim a date of acquisition prior to the date on which the adjustment was applied. This would prevent a taxpayer from benefitting twice from an adjustment for the same period.

The bill would provide that, in cases where a corporation is treated as a collapsible corporation with respect to a distribution or sale of stock (sec. 341), the full amount of gain which would be recognized and taxed as ordinary income under present law would continue to be so treated.

Effective Date

The bill would apply to dispositions of indexed assets after December 31, 1983.

Prior Congressional Action

In 1978, the House passed a provision similar to the bill as part of H.R. 13511, the Revenue Act of 1978. That provision was deleted in conference.

In 1982, the Senate passed a similar provision as part of H.R. 4961, the Tax Equity and Fiscal Responsibility Act of 1982. That provision was deleted in conference.

2. S. 1579—Senator Armstrong

Charitable Expense Deduction for Use of Passenger Automobile

Present Law

Individual taxpayers who itemize their deductions may deduct charitable contributions made to qualified organizations, subject to certain limitations (Code sec. 170(a)).

Individuals who do not itemize deductions may also deduct charitable contributions, subject to limitations (sec. 170(i)). For 1982 and 1983, the deduction is limited to 25 percent of the first $100 of contributions, or a maximum deduction of $25. For 1984, the contribution limit is raised to $300, or a maximum deduction of $75. For 1985, the deduction is allowed for 50 percent of contributions, with no dollar limit, and for 1986 the deduction is allowed for 100 percent of contributions (subject to the general limitations). This provision expires after 1986.

Under present law, a taxpayer may deduct unreimbursed out-of-pocket expenses incurred incident to the rendition of services provided to a charitable organization, such as fuel costs for a vehicle (Treas. Reg. sec. 1.170A-1(g)). In determining the amount of the contribution deduction attributable to the operation of a vehicle, the taxpayer may deduct actual expenses or, may use a standard rate. As most recently established, this rate is nine cents a mile.[8] Under either computation method, the taxpayer may also deduct parking fees and tolls, but may not deduct general repair or maintenance expenses, depreciation, or insurance.

Explanation of the Bill

Under the bill, taxpayers could determine the amount of their charitable contribution deduction for the use of a passenger automobile under the standard mileage rate applicable for that year in computing the business expense deduction (sec. 162) for business use of a passenger automobile.

As most recently established, the standard mileage rate which may be used in computing the business expense deduction for business use of a passenger automobile (if the vehicle is not fully depreciated) is 20 cents a mile for the first 15,000 miles of business use during the taxable year, and 11 cents a mile for each additional mile.[9]

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[8] This rate was established in a revenue procedure issued by the Internal Revenue Service (Rev. Proc. 82-61, 1982-2 C.B. 849).

[9] Rev. Proc. 82-61, *supra* note 8.

Effective Date

The provisions of the bill would apply to taxable years beginning after 1982.

3. S. 108—Senators Grassley, Jepsen, Durenberger, and Thurmond

Tax Incentives for Vocational Education Programs

a. Increased charitable deduction for contributions of equipment to postsecondary vocational education programs

Present Law

In general, the amount of charitable deduction otherwise allowable for donated property must be reduced by the amount of any ordinary gain which the taxpayer would have realized had the property been sold for its fair market value on the date of the donation (Code sec. 170(e)).

Thus, a donor of inventory or other ordinary-income property (property the sale of which would not give rise to long-term capital gain) generally may deduct only the donor's basis in the property, rather than its full fair market value. In the case of property used in the taxpayer's trade or business (sec. 1231 property), the charitable deduction must be reduced by the amount of depreciation recapture which would be recognized on sale of the donated property.

Under a special rule, corporations are allowed an augmented charitable deduction for donations of newly manufactured scientific equipment or apparatus to a college or university for research use in the physical or biological sciences (sec. 170(e)(4), enacted in the Economic Recovery Tax Act of 1981).[10] The augmented deduction is generally for the sum of (1) the corporation's basis in the donated property and (2) one-half of the unrealized appreciation (i.e., one-half of the difference between the property's fair market value determined at the time of the contribution and the donor's basis in the property). However, in no event is the deduction under the special rule allowed for an amount which exceeds twice the basis of the property.

Explanation of Provision

Overview

Section 1 of the bill would provide an augmented charitable deduction for taxpayers (not limited to corporations) making certain donations of tangible personal property to a public community college or public technical institute (within the meaning of sec. 742(b) of the Higher Education Act of 1965 [11]), or any other institution of

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[10] Under a special rule enacted in 1976, an augmented charitable deduction also is allowed for corporate contributions of certain types of ordinary income property donated for the care of the needy, the ill, or infants (sec. 170(e)(3)).

[11] Section 742(b) of the Higher Education Act of 1965, as amended, defines a public community college or public technical institute as an institution of higher education which is under public supervision and control, and is organized and administered principally to provide a two-

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higher education (within the meaning of section 1201(a) of such Act [12]), if the donated property is used for training students enrolled in a postsecondary vocational education program.

Requirements for favorable treatment

To qualify, a donation of equipment would be required, under the bill, to satisfy the following requirements:

(1) The donated property must not be transferred by the donee in exchange for money, other property, or services;

(2) Substantially all of the use of the property by the donee must be for training students enrolled in a postsecondary vocational education program offered by the donee; and

(3) The taxpayer must receive from the donee a written statement representing that the use and disposition of the donated property will be in accordance with the last two requirements.

A postsecondary vocational education program would be defined as any organized education program which is either (1) a two-year program in engineering, mathematics, or the physical or biological sciences, designed to prepare a student to work as a technician or at the semiprofessional level in engineering, scientific, or other technological fields requiring the understanding and application of basic engineering, scientific, or mathematical principles of knowledge, or (2) directly related to the preparation of individuals for paid or unpaid employment or for a career which does not require a baccalaureate or advanced degree.

Allowable deduction

If all the requirements of section 1 of the bill are satisfied, the augmented charitable deduction allowed for the donation of equipment generally would be the sum of (1) the taxpayer's basis in the

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year program which is acceptable for full credit toward a bachelor's degree, or a two-year program in engineering, mathematics, or the physical or biological sciences which is designed to prepare the student to work as a technician and at a semiprofessional level in engineering, scientific, or other technological fields which require the understanding and application of basic engineering, scientific, or mathematical principles or knowledge; and the term includes a branch of an institution of higher education offering four or more years of higher education which is located in a community different from that in which its parent institution is located (20 U.S.C. sec. 1132e–1).

[12] Section 1201(a) of the Higher Education Act of 1965, as amended, defines an institution of higher education as an educational institution in any State which (1) admits as regular students only persons having a certificate of graduation from a school providing secondary education, or the recognized equivalent of such a certificate; (2) is legally authorized within such State to provide a program of education beyond secondary education; (3) provides an educational program for which it awards a bachelor's degree or provides not less than a two-year program which is acceptable for full credit toward such a degree; (4) is a public or other nonprofit institution; and (5) is accredited by a nationally recognized accrediting agency or association or, if not so accredited, (A) is an institution with respect to which the Secretary [of Education] has determined that there is satisfactory assurance, considering the resources available to the institution, the period of time, if any, during which it has operated, the effort it is making to meet accreditation standards, and the purpose for which this determination is being made, that the institution will meet the accreditation standards of such an agency or association within a reasonable time, or (B) is an institution whose credits are accepted, on transfer, by not less than three institutions which are so accredited, for credit on the same basis as if transferred from an institution so accredited. such term also includes any school which provides not less than a one-year program of training to prepare students for gainful employment in a recognized occupation and which meets the provisions of clauses (1), (2), (4), and (5). For purposes of this subsection, the Secretary [of Education] shall publish a list of nationally recognized accrediting agencies or associations which he determines to be reliable authority as to the quality of training offered. Such term also includes a public or nonprofit private educational institution in any State which, in lieu of the requirement in clause (1), admits as regular students persons who are beyond the age of compulsory school attendance in the state in which the institution is located who have the ability to benefit from the training offered by the institution (20 U.S.C. sec. 1141).

donated property and (2) one-half of the unrealized appreciation. However, in no event would a deduction be allowed for any amount which exceeded twice the basis of the property.

Effective Date

The provisions of section 1 of the bill would be effective for donations made after 1982.

b. Postsecondary vocational education instruction tax credit

Present Law

In general, employers may deduct as an ordinary and necessary business expense a reasonable allowance for salaries or other compensation for personal services actually rendered (sec. 162). Thus, a manufacturer generally may deduct reasonable compensation paid to an employee who, while regularly employed by the manufacturer in a nonteaching capacity, teaches vocational education courses part-time at a teaching institution, with or without compensation. In addition, a manufacturer generally may deduct reasonable compensation paid to a vocational education teacher regularly employed by a teaching institution who works temporarily for the manufacturer to upgrade his or her skills.

Under present law, a targeted jobs tax credit is also available, on an elective basis, to employers who hire individuals from one or more of nine target groups (sec. 51). One such group consists of youths between the ages of 16 and 20 from economically disadvantaged families who receive instruction in and otherwise actively participate in certain cooperative vocational education programs. The targeted jobs credit is not available with respect to individuals who teach vocational education courses.

Explanation of Provision

General rules

Section 2 of the bill would provide a new tax credit with respect to (1) postsecondary vocational education courses taught by qualified teaching employees of the taxpayer and (2) qualified vocational education instructors temporarily employed by the taxpayer.

The amount of the credit generally would be $100 for each postsecondary vocational education course taught by a qualified teaching employee during the taxable year (not to exceed five courses per employee per taxable year), plus $100 for each qualified vocational education instructor temporarily employed during the taxable year.

Definitions

A postsecondary vocational education course would be defined as any course of instruction which—

(1) Is offered by an institution of higher education as part of either (a) a two-year organized education program in engineering, mathematics, or the physical or biological sciences, designed to prepare a student to work as a technician or at the semiprofessional level in engineering, scientific, or other technological fields requir-

ing the understanding and application of basic engineering, scientific, or mathematical principles of knowledge, or (b) an organized education program directly related to the preparation of individuals for paid or unpaid employment or for a career which does not require a baccalaureate or advanced degree;

(2) Consists of a period of instruction which is at least equivalent to a course of instruction that provides three hours of instruction per week during an academic semester; and

(3) Has been completed before the close of the taxable year.

A qualified teaching employee would be defined as any individual employed full time by the taxpayer for the entire taxable year who taught at least one postsecondary vocational education course part-time at an institution of higher education (within the meaning of sec. 1201(a) of the Higher Education Act of 1965 [13]), does not receive any compensation from the institution of higher education, and was not a qualified vocational education instructor at any time during the taxable year.

A vocational education instructor would be defined as any individual who—

(1) Was employed full time by the taxpayer for at least three months but not more than 12 months during the two-year period ending at the close of the taxable year;

(2) Prior to this employment, taught postsecondary vocational education courses full-time at an institution of higher education;

(3) Is teaching such courses full-time at an institution of higher education at the close of the taxable year; and

(4) Is not employed by the taxpayer at the close of the taxable year.

Double benefit

Any credit allowed under the bill with respect to an employee would be in addition to any allowable deduction for reasonable compensation paid to the employee by the taxpayer.

Limitations and special rules

The amount of the vocational education instruction credit allowable in any taxable year generally would be limited to the taxpayer's income tax liability for the year reduced by (1) certain items of tax described in the last sentence of Code section 53(a), and (2) the sum of various other statutory credits allowable in the taxable year.[14]

In addition, in the case of a taxpayer who owns an interest in an unincorporated trade or business, is a partner in a partnership, is a beneficiary of an estate or trust, or is a shareholder in an electing small business corporation, the amount of the vocational education credit attributable to such trade, business or entity which would be applied against tax could not exceed the amount of the taxpayer's

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[13] See note 12, *supra*.

[14] The statutory credits which would be applied against tax before the vocational education instruction credit are: all allowable credits having a lower letter or number designation in the Code than the vocational education instruction credit (sec. 44H under the bill), except the wage withholding credit (sec. 31), the credit for certain uses of gasoline and special fuels (sec. 39), and the earned income credit (sec. 43).

total tax attributable to the taxpayer's share of income from the trade, business, or entity.

Special rules governing the computation and allocation of the credit are included in the bill for controlled groups of corporations and trades or businesses under common control. The bill would also authorize the Treasury to adopt regulations governing pass-through of the credit, in the case of S corporations (under rules similar to those of Code secs. 52(d) and 52(e)), and allocation of the credit, in the case of partnerships.

Effective Date

The provisions of section 2 of the bill would be effective for taxable years beginning after 1982.

4. S. 1464—Senators Armstrong and Hart

Exemption from Divestiture Requirements of Excess Business Holdings Provision for the El Pomar Foundation

Present Law

The Tax Reform Act of 1969 imposed an excise tax on the excess business holdings of a private foundation (Code sec. 4943). Generally, under the excess business holdings provision, the combined ownership of a business by a private foundation and all disqualified persons cannot exceed 20 percent of the voting stock of the business (35 percent if other persons have effective control of the business).

The 1969 Act provided that if a private foundation and disqualified persons together had holdings on May 26, 1969 in excess of the permitted amounts under the general rules, then those holdings could be retained for an initial transitional period. Following that period, the combined holdings must be reduced to 50 percent. Ultimately, the combined holdings must be reduced to 35 percent if the disqualified persons hold, in the aggregate, no more than two percent of the business after the initial transition period. If the disqualified persons hold more than two percent, then the combined holdings may continue to be as much as 50 percent, but the foundation itself may hold no more than 25 percent of the voting stock.

Explanation of the Bill

The bill would provide that the divestiture requirements of the excess business holding provisions (sec. 4943) would not apply to a private foundation which meets the following conditions: (1) the foundation owned (directly or through a holding company), on May 26, 1969, 100 percent of the voting stock in an incorporated business enterprise substantially all of the operating assets of which are used in operating a hotel business enterprise; (2) the stock in the business enterprise was acquired by gift, devise, or bequest before December 31, 1966; (3) neither the donor nor any of the members of the donor's family was a foundation manager on or after December 31, 1956; (4) on May 26, 1969, and at all times thereafter, the hotel business enterprise is substantially the same character as the enterprise which was conducted by the corporation on the date of the last gift, devise, or bequest by any donor of any stock in the business enterprise; (5) on May 26, 1969, and at all times thereafter, substantially all of the operating assets are used in operating the hotel business enterprise; and (6) the foundation does not acquire on or after May 26, 1969, any interest in a business enterprise that would constitute excess business holdings.

It is understood that the intended beneficiary of the bill is the El Pomar Foundation of Colorado Springs, Colorado. However, any

private foundation that meets the requirements of the bill would qualify for exemption from the divestiture rules.

Effective Date

The provisions of the bill would be effective on the date of enactment.

Prior Congressional Action

In 1982, the Senate passed a similar provision as part of H.R. 4961, the Tax Equity and Fiscal Responsibility Act of 1982. That provision was deleted in conference. Also, a similar provision was added by the Committee on Finance to H.R. 4577, as reported by the Committee on November 15, 1982. No further action was taken on that bill in the 97th Congress.

5. S. 1549—Senators Armstrong, Long, Durenberger, Wallop, Grassley, Symms, Bentsen, Baucus, Boren, and Pryor

Exemption from Unrelated Business Income Tax for Income from Certain Oil and Gas Property

Present Law

In general

Under present law, most organizations which generally are exempt from Federal income taxation under Code section 501(a), including any trust that is part of a tax-qualified pension, profit-sharing, or stock bonus plan described in section 401(a), are subject to tax on any unrelated business taxable income (secs. 511-514). In addition, a tax is imposed on the unrelated trade or business income of an individual retirement account or annuity (an IRA).[15] The term unrelated trade or business generally means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the activities for which the organization was granted tax exemption.

Under present law, a tax-exempt organization is treated as being engaged in the same activities as any partnership (whether limited or general) in which the organization invests. Accordingly, if a tax-exempt organization becomes a limited partner in a partnership that owns a working interest in oil and gas properties and the working interest is not substantially related to the organization's exempt function, the income derived from the working interest is subject to the unrelated trade or business tax.

Debt-financed property

Present law also provides that the income of an exempt trust or organization, or an IRA, from debt-financed property which is unrelated to its exempt function is subject to the unrelated business income tax in the proportion in which the property is financed by the debt (sec. 514). Debt-financed property means all property (e.g., rental real estate, tangible personal property, and corporate stock) that is held to produce income and with respect to which indebtedness was incurred to acquire or improve the property or an indebtedness would not have been incurred but for the acquisition or improvement of the property.

A special rule applies under present law to real property acquired by a tax-exempt trust forming part of a tax-qualified pension, etc., plan. Under this rule, debt-financed real property ac-

[15] Sec. 408(e)(1).

quired by an exempt trust is not treated as debt-financed property unless one of the following applies:

(1) the acquisition price is not a fixed amount determined as of the date of acquisition;

(2) the amount of any indebtedness or any other amount payable with respect to such indebtedness, or the time for making any payment with respect to the indebtedness, is partially or wholly dependent upon any revenue, income, or profits derived from the real property;

(3) the real property is at any time after acquisition leased by the trust to the seller or to any person related to the seller (within the meaning of sec. 267(b));

(4) the real property is acquired from or, at any time after acquisition, is leased to any person that bears a certain relationship to the trust; or

(5) the seller or any person related to the seller or the trust (as described in (3) or (4)) provides the trust with nonrecourse financing in connection with the acquisition and the debt is subordinate to any other indebtedness on the property or bears interest at a rate that is significantly lower than the prevailing market interest rate.

Explanation of the Bill

In general

Under the bill, certain exempt organizations would be permitted to invest in working interests in domestic oil and gas properties without incurring tax for unrelated business income. The organizations that would be eligible under this provision include exempt trusts forming a part of tax-qualified pension, etc., plans, IRAs, and tax-exempt educational organizations described in Code sections 170(b)(1)(A)(ii) or 170(b)(1)(A)(iv).

In order to qualify under the special rule, the trust or organization must receive income from the working interest in oil and gas property as a limited partner from a limited partnership. In addition, the limited partnership could not, at any time during the partnership taxable year for which an income allocation is made —

(i) allocate to the limited partners a share of any item of deduction, loss, or credit that is less than the limited partners' share of income or gain;

(ii) allocate among the limited partners any item of deduction, loss, or credit that differs from the ratio in which they share income or gain;

(iii) allocate cash distributions to partners (limited or general) in a manner that differs from the allocation of income or gain.

However, these restrictions would not apply if the allocations of depreciation, depletion, gain, or loss take account of the variation between the basis of property to the limited partnership and its fair market value at the time of its contribution to the partnership and if the allocations are permissible under Treasury regulations.[16]

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[16] Sec. 704(c)(2).

For purposes of determining whether an exempt trust or organization is a limited partner or a general partner in a limited partnership, the interests of certain related parties would be taken into account. In addition, an exempt trust or organization which is a limited partner would be treated as owning an interest in any general partner held by any other exempt trust or organization (including related persons) that is a partner in the partnership.

The bill authorizes the Treasury Department to prescribe regulations that would deny the special treatment under the bill in any case in which multi-tier partnerships or other arrangements are used for the principal purpose of avoiding the conditions of the bill.

Debt-financed property

The bill would provide an exception to the rules relating to debt-financed property for working interests in domestic oil and gas properties acquired by tax-qualified pension, etc., plans, IRAs, or certain educational organizations, which would be similar to the rules, under present law, that apply to investment by tax-qualified pension, etc., plans in debt-financed real property.

Under these rules, the exemption would only apply if the acquisition price is a fixed amount and payments are not dependent upon the profits from the property (items 1 and 2 under present law, above). However, the limitations relating to leases between related parties, acquisitions from related parties, and nonrecourse financing from related parties (items 3, 4, and 5, above) would not apply to any acquisition, lease, farm-out, or other transfer of a working interest to a person related to the general partner if the terms of the transfer are consistent with the terms of similar transfers in the same geographic area.

Effective Date

The bill would apply for partnership taxable years beginning after 1982.

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